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Company Examinations

REPORT ON EXAMINATION

of

PRE-PAID LEGAL SERVICES OF TENNESSEE, INC.

Ada, Oklahoma

as of

December 31, 2001

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Dept. Of Commerce & Insurance
Company Examinations

**THE DEPARTMENT OF COMMERCE AND INSURANCE
STATE OF TENNESSEE
Nashville, Tennessee**

Exhibit

TABLE OF CONTENTS

Item

Salutation.....	1
Introduction	1
Scope of Examination	2
Company History	3
Capital Stock.....	3
Charter and Bylaws.....	3
Management and Control.....	4
Corporate Records	5
Affiliated Companies.....	5
Fidelity Bond and Other Insurance.....	7
Officers', Employees', and Welfare and Pension Plans.....	7
Statutory Deposit.....	8
Territory And Plan of Operation.....	8
Attorney Provider Agreement.....	9
Growth of Company.....	10
Loss Experience.....	10
Reinsurance.....	11
Market Conduct Activities.....	11
Accounts and Records.....	13
Litigation and Contingent Liabilities.....	13
Financial Statement.....	14
Analysis of Changes in Financial Statement and Comments Resulting from Examination.....	19
Comments and Recommendations.....	21
Conclusion.....	23
Examination Affidavit.....	24
Organizational Chart.....	25

Ada, Oklahoma
December 30, 2003

Honorable Paula A. Flowers
Commissioner of Commerce and Insurance
State of Tennessee
500 James Robertson Parkway
Nashville, Tennessee 37243-1135

Dear Commissioner:

Under authority delegated by you and in compliance with instructions, a financial examination and market conduct review has been made of

PRE-PAID LEGAL SERVICES OF TENNESSEE, INC.
Ada, Oklahoma

hereinafter generally referred to as the "Company." The Company was examined at its main administrative office, 321 East Main Street, Ada, Oklahoma, and a report thereon is submitted as follows:

INTRODUCTION

This examination as of December 31, 2001, was arranged by the Department of Commerce and Insurance of the State of Tennessee (The Department) under rules promulgated by the National Association of Insurance Commissioners. It was commenced on December 2, 2002, and was conducted by a duly authorized representative of the Department of Commerce and Insurance, State of Tennessee.

The previous examination consisted of an organizational examination and was made as of March 2, 1998 by an examiner of the State of Tennessee. The organizational examination took place at the Company's registered agent's office located at 530 Gay Street in Knoxville, Tennessee.

The Department noted that the Company does not file with the National Association of Insurance Commissioners pursuant to the Tenn. Code Ann. 56-43-111(e)(2). In addition, the Tenn. Code Ann. 56-2-104(5) requires a Company's books and records to be maintained in the State of Tennessee if licensed after July 1, 1993, however, the Department indicated that certain statutes are not applicable to this Company pursuant to Tenn. Code Ann. 56-43-111.

SCOPE OF EXAMINATION

The period covered hereunder is from March 2, 1998, the date of the previous examination, to the close of business on December 31, 2001, the date of this examination.

During the course of examination, assets were verified and valued, and liabilities were determined or estimated as of December 31, 2001. The Company's financial solvency and the degree thereof were established. Test checks covering selected periods were made of income and disbursement items, and a general review was made of the Company's operations, practices, and compliance with statutes, to the extent hereinafter set forth.

An examination of all asset and liability items contained in the financial statement of this report was made and individual items were verified with equal emphasis, regardless of size or their potential impact on surplus funds as regards policyholders.

An examination encompassed a review of the following matters:

- Company History
- Capital Stock
- Charter and By-Laws
- Management and Control
- Corporate Records
- Affiliated Companies
- Fidelity Bond and Other Insurance
- Officers', Employees', and Agents' Welfare and Pension Plans
- Statutory Deposit
- Territory and Plan of Operation
- Attorney Provider Agreement
- Growth of Company
- Loss Experience
- Reinsurance
- Market Conduct Activities
- Accounts and Records
- Litigation and Contingent Liabilities
- Financial Statement

They are discussed in detail as follows:

COMPANY HISTORY

The Company was incorporated on December 3, 1997 under the Tennessee Business Corporation Act as a for-profit legal insurance company. On April 20, 1998 the Company was issued a certificate of authority to transact the business of legal insurance pursuant to the Tennessee Code Annotated Title 56, Chapter 43.

CAPITAL STOCK

In accordance with the Company's charter, the total number of shares of common stock the Company is authorized to issue is 500,000 shares at a par value of \$1.00 per share. On March 2, 1998 the Board of Directors of the Company approved the issuance of 250,000 shares of its common stock to its wholly-owned parent, Pre-Paid Legal Casualty, Inc. for payment of \$2.00 per share.

As of March 2, 1998, the Company reported common stock of \$250,000 and gross paid in and contributed surplus of \$250,000.

A review of the stock certificate indicated that 250,000 shares were issued and outstanding to Pre-Paid Legal Casualty, Inc., effective March 2, 1998.

CHARTER AND BY-LAWS

Charter:

The Company's original charter was dated November 24, 1997 and authorized it to transact legal insurance as authorized pursuant to Tenn. Code Ann. § 56-43-104(a)(2) and to transact any other lawful business. The charter indicated the Company's principal office to be located in Ada, Oklahoma. The charter named the Company's initial registered agent as C.T. Corporation Systems and its registered office to be located in Knoxville, Tennessee. The charter was stamped approved by the Commissioner of Insurance State of Tennessee on November 26, 1997.

The Company amended its charter to reflect county changes in Knoxville, Tennessee. The change was a result from Davidson County to Knox County. This amendment was also approved by the Commissioner of Insurance State of Tennessee effective April 15, 1998. This amendment was also filed with the Secretary of State on the same date.

Bylaws:

The bylaws of the Company are such as generally found in corporations of this type and contained no unusual provisions. As of the date of this examination it appears there have been no amendments to the Company's bylaws.

MANAGEMENT AND CONTROL

For the period covered by this examination, the Company held its regular meetings of the stockholders.

The management and affairs of the Company are vested in a Board of Directors. The number of directors shall consist of no less than one and no more than ten members. Directors shall be elected at the first annual stockholders' meeting and at each annual meeting thereafter. The following persons were elected directors at the annual stockholders meeting, and held office as such at December 31, 2001:

<u>Name</u>	<u>Occupation</u>
Harland C. Stonecipher	Chief Executive Officer, Pre-Paid Legal Services, Inc.
Randy Harp	Chief Operating Officer, Pre-Paid Legal Services, Inc.
Kathleen S. Pinson	Vice-President of Regulatory Compliance, Pre-Paid Legal Services, Inc.

Directors meet annually immediately following the annual stockholders meeting and may meet more often by special call.

The Board of Directors may create one or more committees, each consisting of one or more members. The creation of a committee and appointment of a member(s) to it must be approved by the greater, of a majority of all directors in office when the action is taken or the number of directors required by the Charter or Bylaws to take action.

The bylaws provide that the Company will have a president, a secretary and such other officers as may be from time to time appointed by the Board of Directors. One person may simultaneously hold more than one office except the president may not simultaneously hold the office of secretary.

The officers shall be appointed annually by the Board of Directors at the first meeting of the Board following the annual meeting of the shareholders or as soon thereafter as is conveniently possible. Each officer shall serve at the pleasure of the Board of Directors and until his successor shall have been appointed, or until his death, resignation or removal.

The following persons were serving as officers at December 31, 2001:

Name**Office**

Randy Harp
Kathleen S. Pinson

President
Secretary and Treasurer

CORPORATE RECORDS

From a review of the shareholders minutes, there was indication that adequate approval was given for Company transactions and events. Further, the minutes indicated a review by the shareholders of the financial statements of the Company for the years under examination.

For each of the years under examination, the Annual Statements, General Interrogatories page indicated that the Company had an established procedure for the disclosure of conflict of interest. During the course of the examination, there was no indication that there were any conflict of interest statements completed for any of the years under examination.

AFFILIATED COMPANIES

The Company is wholly-owned by Pre-Paid Legal Casualty, Inc. (PPLC). PPLC is an insurer domiciled in the State of Oklahoma, which in turn, is a wholly owned subsidiary of Pre-Paid Legal Services, Inc. (PPLSI) the ultimate controlling entity. PPLSI is a publicly owned holding company listed on the New York Stock Exchange under the symbol PPD.

An organizational chart of the holding company system is located on the last page of this examination report.

Management Agreement

On April 20, 1998 the Company executed a management agreement, to commence and become effective January 1, 1998 with its ultimate parent company, Pre-Paid Legal Services, Inc., (PPLSI) an Oklahoma corporation.

The agreement states that PPLSI shall provide the Company with certain record-keeping, accounting services and administration assistance, including, but not limited to:

- Processing of each application for a contract received by the Company.
- The preparation and issuance of contracts to qualified applicants and the maintenance of adequate business records concerning the contract.
- The disbursements of commissions to sales agents selling the Company's policies in accordance with the commission schedule adopted by the Company for the initial sale of contracts, renewal of contracts, the preparation of IRS forms 1099, and the maintenance

of accounting and other records relating to commissions earned and expenses incurred by each sales agent.

- Processing and adjustment of Provider Attorney per capita fees or other claims for benefits under the contracts issued by the Company.
- The provision of certain customer services to holders of contracts issued by the Company

The agreement also states that PPLSI has the option to advance commissions to sales agents selling the Company's contracts.

Within 15 days after the end of each month during the term of the agreement, PPLSI shall calculate its monthly fees due for its administrative services. Such calculations of the monthly fees are based upon a formula contained within the agreement.

The agreement contains a hold harmless clause, as well as a termination or cancellation article.

It appears that this agreement does not contain the Commissioner's stamp of approval however the agreement has been submitted to the Department along with its application for admission. As noted in the comments from the Department's analyst review, the management agreement has been accepted as filed.

Tax Allocation Agreement

The Company is named under a tax allocation agreement also in effect with Pre-Paid Legal Services, Inc., of Oklahoma. The tax agreement is dated March 8, 2001 and became effective December 31, 2000. Under the provisions of the tax allocation agreement, it is the intent of the parties to provide for the sharing of ongoing consolidated tax liability and for compensation of Members for the use of net operating losses and tax credits in arriving at the consolidated federal income tax liability of the Group, consistent with the method required under the Tax Code. The parties agree that the consolidated federal income tax liability of the Group shall be allocated to the Group in accordance with the ratio of each group's statutory taxable income to the total of all members of the group having statutory taxable income. Members with statutory taxable losses will not be included in the allocation process. Members will not receive a benefit for any statutory taxable losses. Statutory taxable income for Members that are not required to file a statutory statement will use federal taxable income. The foregoing payments are due on or before ninety days following the end of the appropriate taxable year or appropriate quarterly tax estimate due date. No interest is paid or charged on settlement or allocation payments.

If the Group's consolidated federal income tax liability is adjusted for any taxable period or periods, whether by means of an amended return, claim for refund as determined by the IRS, the liability of each Member shall be recomputed under this agreement to give effect to such adjustments.

Also under this tax allocation agreement, Members are required to pay Pre-Paid Legal Services, Inc., an amount equal to the state income tax liability it would have incurred if it filed a separate

return. If the Member incurs only the state minimum tax, no settlement is required.

If either Member receives a benefit for the use of net operating losses or tax credits incurred by the other Member in any state in which the Group files a consolidated return, the Member receiving the benefit shall compensate the other Member for the amount of such benefit. The amount of the benefit shall be computed as the difference between the tax liability of each Member as if it had filed a separate return and the actual liability incurred by the Group.

The tax allocation agreement does not contain the Commissioner's approval stamp however it too was submitted to the Department under the insurance holding company system filings as reviewed by the Department's analyst.

FIDELITY BOND AND OTHER INSURANCE

Pre-Paid Legal Services, Inc., and Subsidiaries were named in an Executive Protection Policy, issued by the Federal Insurance Company, Warren, New Jersey. The policy was effective August 10, 2002 to August 10, 2003. The limits of coverage were \$500,000 with a deductible of \$1,000. The fidelity coverage met the suggested minimum amount pursuant to the NAIC Financial Condition Examiners Handbook. Federal Insurance Company is a licensed insurance company in the state of Tennessee.

For the period under examination, the Company was also issued a certificate of liability insurance insured by the Great Northern Insurance Company, Warren, New Jersey, a licensed insurance company in the state of Tennessee. Such coverage includes:

- General liability
- Automobile liability
- Excess umbrella liability
- Workers compensation and Employers' liability
- Crime

OFFICERS', EMPLOYEES', AND WELFARE AND PENSION PLANS

The Company has a management agreement with the ultimate parent, Pre-Paid Legal Services, Inc.(PPLSI), whereby the Company uses the employees of PPLSI to provide reporting, record keeping and other administrative services. The Company has no employees. PPLSI employees are provided group medical coverage through PPLSI. The medical plans are administered by FiServ Health. The employees are offered spouse and dependent coverage; they share in the cost of these benefits. Coverage commences on the first day of the month following completion of the ninety-day, probationary period.

PPLSI employees have the opportunity to participate in a 401(k) plan offered by PPLSI, the ultimate parent company. The employer makes a matching contribution based upon years of

service equal to up to 100% of the employee contribution up to a maximum of 6% of the employee's gross pay. To receive the employer match the employee must participate in the program. The employee may set aside the maximum allowed by the IRS (determined yearly) of his gross pay on a tax deferred basis. In order to participate in the plan the employee must be at least 21 years of age, be considered a full- time or part-time employee (at least 1,000 hours per calendar year) and complete one year of service. The employee becomes fully vested in employer contributions to the plan after five years of service.

STATUTORY DEPOSIT

In accordance with statutory requirements, the Company maintained the following deposit at December 31, 2001:

<u>Description of Security</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Market Value</u>
Shelby County TN Public Impt & Sch Ser B G O – Due June 1, 2005	\$130,000	\$130,000	\$130,000

The captioned statutory deposit is a general deposit held in Tennessee.

TERRITORY AND PLAN OF OPERATION

At December 31, 2001, the Company was licensed to transact business only in the State of Tennessee.

The Company markets a pre paid legal service Contract which allows a Member access to a law firm for covered legal services under the terms stipulated by the Contract. The primary target market for legal service plans are to individuals whose income level makes them ineligible for local government-sponsored legal aid systems, yet who cannot readily afford to retain an attorney. In exchange for a fixed monthly, quarterly, semi-annual or annual payment, members will be entitled to specified legal services. Each Contract is guaranteed renewable, except in the case of fraud or nonpayment of Contract fees. The Contracts are automatically renewed at the end of each membership payment period, unless the Member cancels prior to the renewal date or fails to make payment on a timely basis.

The basic legal service Contract can range in cost from \$16 to \$25 per month, depending in part, on the schedule of benefits. However the Company has Contracts available through payroll deduction where rates can range from \$14.95 to \$23.95. The Company also has a legal service

Contract (for small business owners) which may cost either \$75 or \$125, depending on the number of employees.

The basic legal service plan Contract is sold as a package consisting of the following five (5) separate benefits known as "Titles".

- Title I: Preventive Legal Services
- Title II: Motor Vehicle Legal Services
- Title III: Trial Defense Services
- Title IV: IRS Audit Legal Services
- Title V: Other Legal Services

It should be noted that under the first four Titles, there are certain exceptions and exclusions which are included in the Contract.

ATTORNEY PROVIDER AGREEMENT

Subsequent to the date of the examination, the examiner was provided an Attorney Provider Agreement for services to begin February 1, 2002. The Agreement was executed November 20 and 21, 2003 by the Company and the Provider.

The Law Firm represents to the Company that the attorneys who participates in providing the services required by said membership contracts will be duly licensed and approved to practice law in any state wherein an action arise and will be in good standing with the Bar Association of any such state. The Law Firm also represents to the Company that the attorneys who participate in providing services, either from Law Firm or referral network, will have no less than two years legal practice experience as a lawyer. The Law Firm will maintain in full force and effect, legal malpractice insurance, also known as errors and omissions insurance, on each of its attorneys, in an amount not less than \$100,000.

The Company shall pay to the Law Firm on a per active member per month basis according to the schedule as noted in Exhibit I of the agreement.

The Company shall sell the plans only to residents of the state of Tennessee and the Law Firm is obligated to deliver services only to residents of the state of Tennessee holding contracts , however, the Law Firm will be responsible for out of state referrals for covered members for covered matters.

The parties to the agreement state that the Contract shall be governed by the laws of the State of Oklahoma and any legal proceedings had thereon shall be in the District Court within and for Pontotoc County, State of Oklahoma.

Based upon a review of the Company's financial statements for the years under review the following amounts were paid to the Attorney Provider as Per Capita Fees, also known as Membership Benefits as follows:

<u>Year</u>	<u>Amount</u>
1998	\$ 96,383
1999	418,611
2000	924,316
2001	1,631,129

GROWTH OF COMPANY

Comparative financial data, as reported in the Company's financial statements, was as follows:

<u>Year</u>	<u>Premium Income Contract Premiums</u>	<u>Attorney Provider Per Capita Fees/ Membership Benefits</u>	<u>Admitted Assets</u>	<u>Capital and Surplus</u>
1998	\$ 343,245	\$ 96,383	\$ 605,687	\$ 549,644
1999	1,334,133	418,611	965,713	857,903
2000	2,652,534	924,316	1,328,929	1,146,992
2001	4,076,275	1,631,129	2,059,323	1,785,259

LOSS EXPERIENCE

The ratio of Attorney Provider Per Capita Fees (Membership Benefits) incurred to premiums earned as reported in the respective annual statements is as follows:

<u>Year</u>	<u>Per Capita Fees Incurred</u>	<u>Premiums Earned</u>	<u>Loss Ratio</u>
1998	\$ 96,383	\$ 343,245	28.08%
1999	418,611	1,334,133	31.38%
2000	924,316	2,652,534	34.85%
2001	<u>1,631,129</u>	<u>4,076,275</u>	<u>40.02%</u>
Total	<u>\$ 3,070,439</u>	<u>\$ 8,406,187</u>	<u>36.53%</u>

REINSURANCE

This Company has no form of reinsurance.

MARKET CONDUCT ACTIVITIES

Policy Forms and Underwriting Practices

A review was made of the Company's approved contract forms and matched to specimen contract forms disseminated to the public. Based upon that review, there were no significant exceptions noted.

Advertising

A review was made of the Company's advertising material. The Company solicits pamphlets to the public which explains the types of Contracts offered. The Company has provided its Associates with advertising guidelines to be followed during their marketing with the public. Based upon the review of the advertisement provided during the examination it did not appear to be misleading or objectionable.

According to the Annual Statements for the years under review, the Company has made the following payments to its Associates:

<u>Year</u>	<u>Amount</u>
1998	\$ 89,173
1999	330,281
2000	673,939
2001	970,629
Total	<u>\$2,064,022</u>

A review was also made of the Associate's appointment with the Company. Based upon that review, there were no significant exceptions noted.

Treatment of Policyholders

During the period under examination, the Examiner was provided with total complaints received by the Company from January 1, 1998 to December 31, 2001. During this time frame it appears the Company received 353 complaints from its Members and/or Associates. Of that amount, the Examiner reviewed at least 20 percent of these complaints which is determined to be within the required sample size established by the NAIC Examiners Handbook.

Based upon that review, the following exceptions were noted:

- Members experienced calling the Provider Attorney on numerous occasions and not receiving a return call or even a response. Instances are noted that when the Member did receive a response, it was usually too late, due to the fact that time had expired for the Member's case. Because of this delay, it was noted that sometimes the Member had to obtain outside assistance.
- Members were misinformed by some Attorneys. Some Members even questioned the Attorneys knowledge or expertise.
- Members experienced long delays for preparation of Wills, Power of Attorneys, or even long delays in getting a Referral Attorney who could take the Member's case.
- Some Members complained about the Attorney's attitude or disposition.
- Not only Members, but some Associates as well, had complaints about the service they experienced from the Provider Attorney. Some Associates have stated that they would have a problem even marketing the Company's product.

During the review of these complaints, there were instances where the Company had to call the Provider Attorney and intercede why there were long delays in getting Attorney assistance to its Members.

The complaint review also reflected that some complaints were experienced by Members prior to the Company becoming licensed in the State of Tennessee.

It should be noted that the Provider Attorney's Staff consist of approximately 26 Attorneys to service the 18,503 Members enrolled with the Company. On occasions, some Member's services were rendered by the use of a paralegal and not an Attorney.

According to management, after going on-line in January 2000 and working closely with Pre-Paid Legal's managing partner and a supervising attorney, it became obvious to the Company that Pre-Paid Legal was not capable of managing the service division. Proper supervision and service was not being provided. Pre-Paid Legal's administrator was replaced with someone with better customer service skills. Pre-Paid Legal hired a tenured attorney, who took over the management of the division. The Company indicates with the new Pre-Paid Legal administrator, goals have been set to please every member that calls in for service.

Privacy of Non-Public Personal Information

Based upon review of the Company's policy for the disclosure of privacy of non-public personal information, it appears that the Company is in compliance with the Tenn. Comp. R. & Regs. 0780-1-72.

ACCOUNTS AND RECORDS

Pre-Paid Legal Services, Inc., (the ultimate controlling entity) utilizes an IBM AS400 computer system. Membership and Sales Associate's databases are maintained on custom software. Programmer analysts and technical support personnel customize programs to meet the Company's needs for membership, commission, licensing and other data. Accounting records, including the general ledger, accounts payable and payroll, are maintained on J D Edwards (JDE) Software. Per Capita payments to the Provider Attorneys and Commission payments to Sales Associates, among other items are calculated via custom programming and the corresponding journal entries are electronically generated to interface with the JDE software.

LITIGATION AND CONTINGENT LIABILITIES

As of December 31, 2001, the Company indicated it had no pending litigation, other than that arising out of the normal course of business, which would adversely affect the financial condition of the Company.

FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of income at December 31, 2001, together with a reconciliation of capital and surplus for the period under review, as established by this examination:

ASSETS

	<u>Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 1,428,000		1,428,000
Cash	348,404	250,000	98,404
Premiums and agents' balances in course of collection	97,182		97,182
Federal income tax recoverable (including \$85,059 net deferred tax asset)	116,667	116,667	0
Investment income due or accrued	8,327		8,327
Receivable from parent, subsidiaries and affiliates	<u>60,743</u>	<u>60,743</u>	<u>0</u>
Totals	<u>\$ 2,059,323</u>	<u>\$ 427,410</u>	<u>\$ 1,631,913</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Taxes, licenses and fees due or accrued		\$ 43,267
Unearned premiums		230,797
		<hr/>
Total liabilities		\$ 274,064
Common capital stock		250,000
Gross paid-in and contributed surplus	250,000	
Unassigned funds (surplus)	<u>857,849</u>	
Surplus		<u>1,107,849</u>
Total capital and surplus		<u>1,357,849</u>
Totals		<u><u>\$ 1,631,913</u></u>

UNDERWRITING AND INVESTMENT EXHIBIT

Premiums earned	<u>\$ 4,076,275</u>
Deductions	
Losses incurred	\$ 1,545,508
Loss expenses incurred	85,621
Other underwriting expenses incurred	<u>1,652,820</u>
Total Underwriting Deductions	3,283,949
Net Underwriting Gain (Loss)	<u>\$ 792,326</u>
 Net investment income	 80,882
 Net gain from operations before dividends to policyholders and federal income taxes	 <u>873,208</u>
Net gain from operations after dividends to policyholders and before federal income taxes	\$ 873,208
Federal income taxes incurred	<u>320,000</u>
Net Income	<u><u>\$ 553,208</u></u>

CAPITAL AND SURPLUS ACCOUNT

Capital and surplus, December 31, prior year	\$ 1,146,992
Net income	<u>553,208</u>
Net unrealized capital losses	(250,000)
Change in nonadmitted assets	<u>(92,351)</u>
Net change in capital and surplus for the year	<u>210,857</u>
Capital and surplus, December 31, current year	<u><u>\$ 1,357,849</u></u>

RECONCILIATION OF CAPITAL AND SURPLUS
FOR THE PERIOD UNDER EXAMINATION

Capital and surplus, December 31, prior year	0
Net income	49,644
Change in nonadmitted assets and related items	0
Capital changes:	
Paid in	250,000
Surplus adjustments:	
Paid in	250,000
	<hr/>
Capital and surplus, December 31, 1998	\$ 549,644
Net income	308,544
Net unrealized capital losses	(285)
Capital and surplus, December 31, 1999	\$ 857,903
Net income	288,804
Net unrealized capital gains	285
	<hr/>
Capital and surplus, December 31, 2000	\$ 1,146,992
Net income	553,208
Net unrealized capital losses	(250,000)
Change in nonadmitted assets	(92,351)
	<hr/>
Capital and surplus, December 31, 2001	\$ 1,357,849
	<hr/>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS
RESULTING FROM EXAMINATION

Cash \$ 98,404

The captioned amount is \$250,000 less than the amount reported by the Company in its 2001 annual statement. The cash was nonadmitted because the Company reported it as a deposit in-transit, however, the deposit was not made by the Company until February 11, 2002.

Federal Income Tax Recoverable
(Including \$85,059 Net Deferred Tax Asset) \$ 0

The above amount is \$116,667 less than the amount reported by the Company in its 2001 annual statement. The decrease represents \$85,059 for net deferred tax asset which was determined not to be calculated pursuant to SSAP No. 10 or Issue Paper No. 83, paragraph 9 of the NAIC Accounting Practices and Procedures Manual. The remaining \$31,608 pertains to an overpayment of taxes which was recorded by the Company as a reduction to the payable account. For report purposes, it was determined that neither amount represents a recoverable.

Receivable from Parent, Subsidiaries and Affiliates \$ 0

The above amount is \$60,743 less than the amount reported by the Company in its 2001 annual statement. That difference was the result of an unsecured obligation not collateralized by the parent company, Pre-Paid Legal Services, Inc., in accordance with the Tenn. Code Ann. § 56-1-405.

SUMMARY SCHEDULE FOR "ANALYSIS OF CHANGES
IN FINANCIAL STATEMENT AND COMMENTS RESULTING
FROM EXAMINATION" AS THEY AFFECT SURPLUS

Unassigned funds (surplus) per December 31, 2001 annual statement \$1,285,259

Adjustments to Unassigned Funds
Increase Decrease

Assets:

Cash \$ 250,000

Federal Income Tax Recoverable
(Including \$85,059 Net Deferred Tax Asset) 116,667

Receivable from Parent, Subsidiaries and Affiliates 60,743

Totals 0 427,410

Net change per Examination (427,410)

Total Unassigned Funds (surplus) per Examination \$ 857,849

COMMENTS AND RECOMMENDATIONS

Comments:

The page number referenced in a parenthesis relates to the examination page where the comment is located.

1. Investments:

- (a.) A review was made of the Company's Custodial Agreement, as well as the Depository Agreement. It appears that the language contained in the custodial agreement did not meet the necessary safeguards and controls noted in the NAIC Financial Condition Examiners Handbook, Part I, Section IV, H, or the Rules .
- (b.) Conflict of interest statements were not completed by each officer and director for the period under examination.
- (c.) A sample was taken of bonds purchased and matched to broker's advices to ascertain whether the securities were recorded on the trade date and not the settlement date in accordance with the NAIC, Accounting Practices and Procedures Manual, SSAP No. 26, paragraph 4. Based upon the sample, it was noted that the Company recorded its securities on the settlement date, contrary to SSAP No. 26, paragraph 4.

- 2. The management agreement the Company has in effect with Pre-Paid Legal Services, Inc., does not contain the Commissioner's stamp of approval. The agreement was submitted to the Department along with its application for admission. As noted in the comments from the Department's analyst review, the management agreement has been accepted as filed. (Page 5)
- 3. The tax allocation agreement does not contain the Commissioner's approval stamp however it too was submitted to the Department under the insurance holding company system filings as reviewed by the Department's analyst. (Page 6)
- 4. Members experienced calling the Provider Attorney on numerous occasions and not receiving a return call or a response. Instances are noted when the Member did receive a response, it was usually too late, due to the fact that time had expired for the Member's case. Because of this delay, sometimes the Member had to obtain outside assistance. Members were misinformed by some Attorneys. Some Members even questioned the Attorneys knowledge or expertise. Members experienced long delays for preparation of Wills, Power of Attorneys, or even long delays in getting a Referral Attorney who could take the Member's case. Some Members complained about the Attorney's

attitude or disposition. Not only Members, but some Associates had complaints about the service they experienced from the Provider Attorney. Some Associates have stated they would have a problem marketing the Company's product.

During the review of these complaints, there were instances where the Company had to call the Provider Attorney and intercede why there were long delays in getting Attorney assistance to its Members. Some complaints reviewed were experienced by Members prior to the Company becoming licensed in the State of Tennessee. (Pages 12 and 13)

Recommendations:

The Company should submit its Management Agreement to the Department of Commerce and Insurance for the stamp approval of the Commissioner of Insurance pursuant to the Tenn. Code Ann. §56-43-107(a).

Recommendation is made that a full scope Market Conduct examination be conducted as soon as possible due to the complaints noted in this current examination as referenced on page 12 of this report. This Market Conduct examination may also determine whether the Company has been able to resolve its complaint problems as indicated by management with its new administration in place.

The Company should complete another Custodial Agreement whereby the language contained in the custodial agreement will meet the necessary safeguards and controls noted in the NAIC Financial Examiners Handbook, Part I, Section IV, H and be in compliance with the Rules of the Tennessee Department of Commerce and Insurance Chapter 0780-1-.46 which provides a standard of responsibility on the part of the custodian which shall not be less than the responsibility of a bailee for hire or a fiduciary under statutory or case law of Tennessee; that securities held by the custodian are subject to instructions of the insurance company and that securities may be withdrawn immediately upon demand of the insurance company.

Whenever the Company decides to purchase any additional bonds, such securities should be recorded on the trade date and not the settlement date in accordance with the NAIC, Accounting Practices and Procedures Manual, SSAP No. 26, paragraph 4.

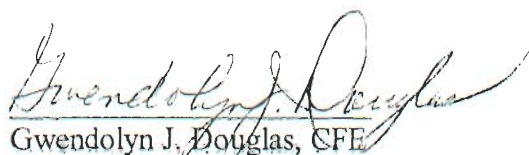
The Company's calculation of the deferred tax asset should be reported in accordance with SSAP No. 10 or Issue Paper No. 83, paragraph 9 of the NAIC Accounting Practices and Procedure Manual.

CONCLUSION

Insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of Pre-Paid Legal Services of Tennessee, Inc., Ada, Oklahoma.

In such manner, it was determined that, as of December 31, 2001, the Company had admitted assets of \$1,631,913 and liabilities, exclusive of capital, of \$274,064. Thus, there existed for the additional protection of the policyholders, the amount of \$1,357,849 in the form of paid-up capital, gross paid-in and contributed surplus and unassigned funds (surplus).

Respectfully submitted,



Gwendolyn J. Douglas, CFE

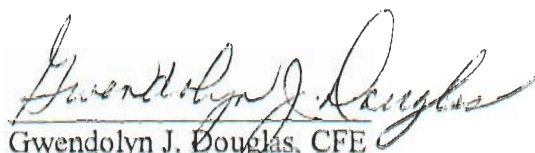
Examiner-in-Charge

State of Tennessee

Southeastern Zone, NAIC

Examination Affidavit

The undersigned deposes and says that she has duly executed the attached examination report of Pre-Paid Legal Services of Tennessee, Inc., dated December 30, 2003 and made as of December 31, 2001, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says she is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of her knowledge, information and belief.

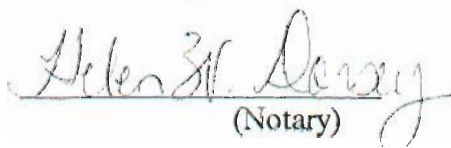


Gwendolyn J. Douglas, CFE
Insurance Examiner
State of Tennessee
N.A.I.C., Southeastern Zone

County Davidson
State Tennessee

Subscribed and sworn to before me

This 13th day of
January, 2004.


(Notary)



Pre-Paid Legal Services®, Inc. Organizational Chart

